

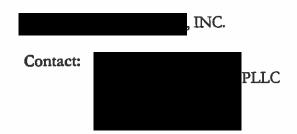
MATTHEW G. BEVIN Governor

FINANCE AND ADMINISTRATION CABINET DEPARTMENT OF REVENUE

501 HIGH STREET FRANKFORT, KENTUCKY 40620 Phone (502) 564-3226 Fax (502) 564-3875 www.kentucky.gov WILLIAM M. LANDRUM III
Secretary

DANIEL P. BORK Commissioner

In the matter of:



FINAL RULING NO. 2016-32 September 16, 2016

Cigarette and Other Tobacco Products Tax Assessments for the Audit Period July 1, 2009 through May 31, 2013

FINAL RULING

The Kentucky Department of Revenue ("DOR") currently has outstanding Cigarette Excise and Other Tobacco Products Tax assessments against totaling \$\frac{1}{2}\text{(plus applicable interest and penalties)} for audit periods of July 1, 2009 through May 31, 2013. A breakdown of the assessments are shown in the chart below:

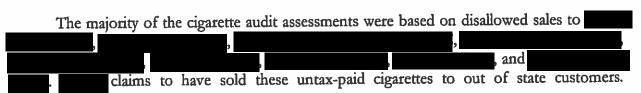
Tax Period	Tax	Interest	Penalty/Fees	Totals	
07/01/2009-	\$	\$	\$	\$	
06/30/2011 07/01/2011-			et et	•	
05/31/2013	\$	*	***************************************		
07/01/2009-	\$	\$	\$	\$	
06/30/2011 07/01/2009-			at a	4	
06/30/2011	\$	*	4		
07/01/2011-	\$	9	\$	\$	
05/31/2013	Q	8	9	<u> </u>	
TOTAL	4	- 15	4	₩	



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In accordance to KRS 131.110, timely protested the assessment and submitted adequate documentation to warrant an adjustment to reduce the original audit assessment to the amounts reflected in the above schedule. For the items remaining in dispute, the Department has determined that was a Kentucky-based resident wholesaler as defined under KRS 138.130(10) and is subject to the tax imposed by KRS 138.130 to 138.205. KRS 138.146 regulates the evidence of tax payments and states "the tax imposed by KRS 138.130 to 138.205 shall be due when any licensed wholesaler or unclassified acquirer takes possession within this state of untax-paid cigarettes." Further, "the tax shall be paid by the purchase of stamps by a resident wholesaler within forty-eight (48) hours after the wholesaler receives the cigarettes. The affixed stamp shall be prima facie evidence of payment of tax." The Department contends the remaining assessments are in accordance to KRS 138.146 and the imposition statutes in KRS 138.140(1)-(5) cited in the following paragraph.

- (1) A tax shall be paid on the sale of cigarettes within the state at a proportionate rate of three cents (\$0.03) on each twenty (20) cigarettes.
- (2) Effective April 1, 2009, a surtax shall be paid in addition to the tax levied in subsection (1) of this section at a proportionate rate of fifty-six cents (\$0.56) on each twenty (20) cigarettes. This tax shall be paid only once, at the same time the tax imposed by subsection (1) of this section is paid.
- (3) Effective June 1, 2005, a surtax shall be paid in addition to the tax levied in subsection (1) of this section and in addition to the surtax levied by subsection (2) of this section, at a proportionate rate of one cent (\$0.01) on each twenty (20) cigarettes. This tax shall be paid at the same time the tax imposed by subsection (1) of this section and the surtax imposed by subsection (2) of this section are paid. The revenues from this surtax shall be deposited in the cancer research institutions matching fund created in KRS 164.043.
- (4) Effective April 1, 2009, an excise tax shall be imposed upon all wholesalers of other tobacco products at the rate of fifteen percent (15%) of the gross receipts of any wholesaler derived from wholesale sales made within the Commonwealth.
- (5) Effective April 1, 2009, a tax shall be imposed upon all wholesalers of snuff at a rate of nineteen cents (\$0.19) per unit. As used in this section, "unit" means a hard container not capable of containing more than one and one-half (1-1/2) ounce. In determining the quantity subject to tax under this subsection, if a package on which the tax is levied contains more than an individual unit, the taxable quantity shall be calculated by multiplying the total number of individual units by the rate set in this subsection.



However, billing records, bills of lading and other documentation examined during the audit revealed many discrepancies in inventory levels from what was reported monthly to DOR for the applicable reporting periods. Specifically, the beginning balance of cigarettes on hand for the 2011 through 2013 audit period, invoices found onsite during the audit were not reported on the originally filed form 73A420 or the amended filed form 73A420 for the previous audit period of July 1, 2009 through June 30, 2011 as required per Kentucky Regulation 103 KAR 41:030. For this reason, inventory was increased to reflect the unreported invoices found during the audit. The Department correctly determined the beginning balance on hand as outlined in the reporting requirements per 103 KAR 41:030 and KRS 138.190.

Furthermore, the sale of untax-paid cigarettes to out of state wholesalers is a clear violation of KRS 138.195(12) which directs that "no person licensed under this section except nonresident wholesalers shall either sell to or purchase from any other such licensee untax-paid cigarettes." As a licensed resident wholesaler, was not allowed to sell untax-paid cigarettes under any circumstances. Kentucky Regulations 103 KAR 41:030 and 41:100 provide guidance on how a KY resident wholesaler is to handle the stamping of cigarettes that are destined for sale into other states.

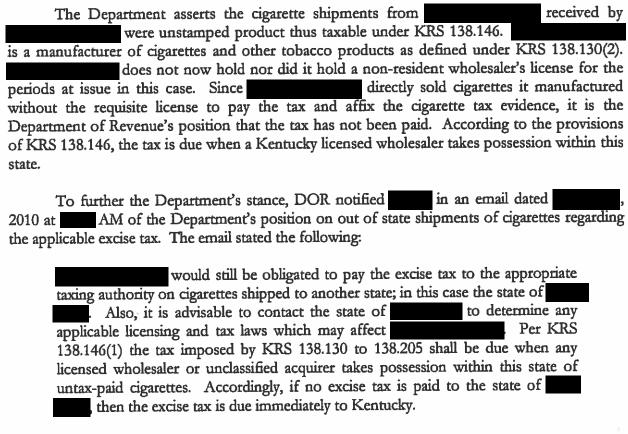
Kentucky Regulation 103 KAR 41:030, Section 2(1)(c) requires the wholesaler to submit a monthly report accounting for the total inventory of cigarettes purchased and stamped with Kentucky or other state stamps. Section 2(2) addresses transactions where a Kentucky wholesaler sells cigarettes into out of state jurisdictions which do not require the affixing of cigarette stamps as proof of tax paid (). In these transactions, the wholesaler must submit to DOR copies of reports to out of state jurisdictions with proof of the other state tax paid. For the audit periods in question, was not licensed to stamp for any out of state jurisdictions even though it claimed to be selling into other jurisdictions such as which has stamping requirements. Furthermore, the company provided no proof that it paid the tax on any product it claims to have shipped into out of state jurisdictions without stamp requirements.

Absent any proof or even authorization to remit cigarette excise tax to out of state tax jurisdictions, the Kentucky tax is imposed on the sale of cigarettes within the state of Kentucky. KRS 138.130 (6) defines "sales" as "any transfer for a consideration, exchange, barter, gift, offer for sale, advertising for sale, soliciting an order for cigarettes or tobacco products, and distribution in any manner or by any means whatsoever."

The OTP audit assessment for the sale to was made in accordance to KRS 138.140(4) & (5). was a licensed Kentucky subjobber as defined under KRS 138.130(12) which states in part as "any person who purchases cigarettes, other tobacco products, or snuff from a wholesaler licensed under KRS 138.195 on which the tax imposed by KRS 138.140 has been paid". By definition, could not receive

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untax-paid product. Therefore, the Kentucky licensed wholesaler is responsible for the tax imposed by KRS 138.140.



The Department assessed interest and penalties in accordance with KRS 131.183(1)(a), and KRS 131.180(2).

KRS 131.183(1)(a) states:

All taxes payable to the Commonwealth not paid at the time prescribed by statute shall accrue interest at the tax interest rate.

KRS 131.180(2) states:

Any taxpayer who fails to withhold or collect any tax as required by law, fails to pay the tax computed due on a return or report on or before the due date prescribed for it or the due date as extended by the department or, excluding underpayments determined pursuant to subsections (2) and (3) of KRS 141.990, fails to have timely paid at least seventy-five percent (75%) of the

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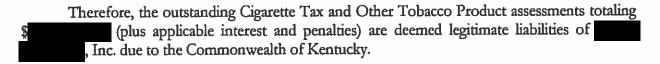
tax determined due by the department shall, unless it is shown to the satisfaction of the department that the failure is due to reasonable cause, pay a penalty equal to two percent (2%) of the tax not withheld, collected, or timely paid for each thirty (30) days or fraction thereof that the withholding, collection, or payment is late. The total penalty levied pursuant to this subsection shall not exceed twenty percent (20%) of the tax not timely withheld, collected, or paid; however, the penalty shall not be less than ten dollars (\$10).

requested a waiver of penalties citing KRS 131.081(6), KRS 131.175 and 103 KAR 1:040, Section (1)(9)(11) & (14).

KRS 131.081(6) states:

If any taxpayer's failure to submit a timely return or payment to the department is due to the taxpayer's reasonable reliance on written advice from the department, the taxpayer shall be relieved of any penalty or interest with respect thereto, provided the taxpayer requested the advice in writing from the department and the specific facts and circumstances of the activity or transaction were fully described in the taxpayer's request, the department did not subsequently rescind or modify the advice in writing, and there were no subsequent changes in applicable laws or regulations or a final decision of a court which rendered the department's earlier written advice no longer valid. Since, the Department clarified the written advice on August 31, 2010 (as cited earlier), Burley is not entitled to a waiver a penalty and interest per KRS 131.081(6).

KRS 131.175 provides the Commissioner the authority to waive penalty when reasonable cause is shown to the satisfaction of the Department. has not shown to the Department of Revenue's satisfaction that failure to file or pay timely was due to reasonable cause as outlined in 103 KAR 1:040.



This letter is the final ruling of the Department of Revenue.

APPEAL

For purposes of this final ruling, the terminology "Kentucky Board of Tax Appeals" and "Board" represent both the current Kentucky Board of Tax Appeals, as well as, the Kentucky Claims Commission that was established by Executive Order on August 8, 2016 and is expected to replace the current Kentucky Board of Tax Appeals on October 1, 2016.

You may appeal this final ruling to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.110, KRS 131.340-131.365, 103 KAR 1:010 and 802 KAR 1:010. If you decide to appeal this final ruling, your petition of appeal must be filed at the principal office of the Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40601-3714, within thirty (30) days from the date of this final ruling. The rules of the Kentucky Board of Tax Appeals, which are set forth in 802 KAR 1:010, require that the petition of appeal must:

- 1. Be filed in quintuplicate;
- 2. Contain a brief statement of the law and facts in issue;
- 3. Contain the petitioner's or appellant's position as to the law and facts; and
- 4. Include a copy of this final ruling with each copy of the petition of appeal.

The petition of appeal must be in writing and signed by the petitioner or appellant. Filings by facsimile or other electronic means shall not be accepted.

Proceedings before the Kentucky Board of Tax Appeals are conducted in accordance with 103 KAR 1:010, 802 KAR 1:010 and KRS 131.340-131.365 and KRS Chapter 13B. Formal hearings are held by the Board concerning the tax appeals before it, with all testimony and proceedings officially reported. Legal representation of parties to appeals before the Board is governed by the following rules set forth in Section 3 of 802 KAR 1:010:

- 1. An individual may represent himself in any proceedings before the Board where his individual tax liability is at issue or he may obtain an attorney to represent him in those proceedings;
- 2. An individual who is not an attorney may not represent any other individual or legal entity in any proceedings before the Board;
- 3. In accordance with Supreme Court Rule 3.020, if the appealing party is a corporation, trust, estate, partnership, joint venture, LLC, or any other artificial legal entity, the entity must be represented by an attorney on all matters before the Board, including the filing of the petition of appeal. If the petition of appeal is filed by a non-attorney representative for the legal entity, the appeal will be dismissed by the Board; and
- 4. An attorney who is not licensed to practice in Kentucky may practice before the Board only if he complies with Rule 3.030(2) of the Rules of the Kentucky Supreme Court.

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You will be notified by the Clerk of the Board of the date and time set for any hearing.

Sincerely,

DEPARTMENT OF REVENUE

Soers Sowell
Attorney Manager
Office of Lordon Office of Legal Services for Revenue

CERTIFIED MAIL RETURN RECEIPT REQUESTED